Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author: Knox | Analyst: Garnier | Bill Number: AB 901

Related Bills: AB 26,AB 75 (1999) | Telephone: 845-5322 | Amended Date: 4/12/1999

Attorney: Doug Bramhall | Sponsor:

SUBJECT: Exclusion/Employer-Provided Medical Insurance Benefits/Includes Domestic Partners

SUMMARY OF BILL

This bill would extend the exclusion of employer-provided health insurance benefits received by the taxpayer for the benefit of the taxpayer's spouse or dependents to the taxpayer's domestic partner or domestic partner's dependents. This bill would also allow a taxpayer to deduct, as an itemized medical expense deduction, the medical expenses of the taxpayer's domestic partner and the domestic partner's dependents.

SUMMARY OF AMENDMENT

The bill, as originally introduced on February 25, 1999, would have provided for the exclusion from gross income of amounts received under a employer-provided accident and health plan by an employee for reimbursement of medical expenses paid by the employer for medical expenses of the employee's domestic partner. As originally introduced, the bill also would have defined "domestic partner" in the Personal Income Tax Law (PITL). The bill, as introduced, was not analyzed by the department.

The amendment would expand the gross income exclusion of employer-provided healthcare insurance benefits to include benefits received by the taxpayer covering the taxpayer's domestic partner or domestic partner's dependents. The amendment also would allow the taxpayer to deduct the medical expenses of the taxpayer's domestic partner or the domestic partner's dependents. The amendment also removed the domestic partner definition from the PITL and defines a domestic partner by reference to Section 297 of the Family Code.

EFFECTIVE DATE

As a tax levy, this bill would be effective for taxable years beginning on or after January 1, 1999.

SPECIFIC FINDINGS

Under **federal and California law**, a taxpayer may deduct as an itemized deduction medical expenses that are not reimbursed by insurance or otherwise and that exceed 7.5% of the taxpayer's adjusted gross income (AGI). Medical expenses include amounts paid for diagnosis, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body. Medical care also includes the cost of certain travel and lodging to obtain the medical care, accident and health insurance, eligible long-term care insurance, and prescription drugs.

Board Position:			Department Director	Date
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The taxpayer also may deduct the cost of capital improvements (e.g., elevators and swimming pools) that exceed the value the improvement added to the property. Capital improvements must be recommended by a qualified physician.

Long-term care insurance contracts (LTCIC) qualify as a medical expense if certain conditions are met. Among other required conditions, the LTCIC can only provide long-term care services to chronically ill individuals and must be prescribed by a licensed health care practitioner.

Because state-maintained long-term care plans are not insurance contracts per se, special rules apply. State-maintained long-term care plans have the same requirements as LTCIC except that the state-maintained plan must:

- Be established and maintained by a state or instrumentality thereof,
- only provide qualified long-term care services as defined under qualified LTCICs, and
- only provide coverage to an employee or former employee of the state (or any political subdivision or instrumentality thereof) and the spouse or certain dependents of the employee or former employee.

If the state-maintained plan does not meet all of the above requirements (e.g., provides coverage to an individual other than an employee or former employee or spouse or certain dependents of the employee or former employee), the costs of a state-maintained plan would not qualify as a medical expense under federal law.

The eligible medical expense deduction for long-term care insurance is limited as follows:

Individuals age of	Limitation
40 or less	$ 200
More than 40 but less than 50	375
More than 50 but less than 60	750
More than 60 but less than 70	2,000
More than 70	2,500

Federal and California law provides that the gross income of an employee does not include the value of employer-provided accident and health insurance. The employer may deduct the cost of the employee’s health insurance as an ordinary and necessary business expense.

Further, **current law** allows self-employed individuals to deduct a certain percentage of the cost of health insurance from gross income. Under **federal law** the current deductible percentage is 60%; **under state law** the current deductible percentage is 40%. Under both federal and state law, the deduction from gross income is not allowed if the individual or individual’s spouse is eligible to participate in any subsidized health plan of any employer of the individual or individual’s spouse. Under both federal and state law, the cost of health insurance not deductible from gross income because of the deductible percentage or other limitations may be deducted as an itemized deduction subject to the 7.5% of AGI floor.

Federal and state law also provides that gross income does not include reimbursement of a medical expense that was not deducted in any taxable year.

Finally, under both **federal and California law,** the deduction of medical expenses or exclusion from income as discussed above applies to the individual taxpayer, the taxpayer's spouse and their dependents.

This bill would provide that the taxpayer's domestic partner be treated as the spouse of the taxpayer for purposes of determining the medical expenses:

- deductible as an itemized deduction,
- deductible as an adjustment to gross income for self-employed individual health insurance,
- excludable from gross income as employer-provided accident and health insurance.
- excludable as medical expenses reimbursement if the expense was not previously deducted.
- deductible as long-term health care insurance.

Domestic partner would be defined by reference to Family Code §297. The current Family Code does not have a section 297. AB 26 (Migden), introduced on December 7, 1998, would add Section 297 to the Family Code. As proposed to be added by AB 26, Family Code Section 297 would define domestic partners as two adults in a domestic partnership that satisfies all of the following requirements:

(1) Both persons "have a common residence," which is defined to mean that two people are cohabitants. It is not necessary that the legal right to possess the common residence be in both of their names. Two people are cohabitants even if one or both have additional residences. Domestic partners do not cease to be cohabitants if one leaves the common residence but intends to return.
(2) Both persons agree to be "jointly responsible" for each other's "basic living expenses" during the domestic partnership. Jointly responsible means that each partner agrees to provide for the other partner's basic living expenses if the partner is unable to provide for herself or himself. Anyone to whom these expenses are owed may enforce this responsibility. "Basic living expenses" means food and shelter. It also means any other cost, such as medical care, if some or all of the cost is paid as a benefit because a person is another person's domestic partner.
(3) Neither person is married or a member of another domestic partnership.
(4) The two persons are not related by blood in a way which would prevent them from being married to each other in this state.
(5) Both persons are at least 18 years of age.
(6) Both file a Declaration of Domestic Partnership with the Secretary of State pursuant to Division 2.5 (Domestic Partner Registration) of the Family Code.

SB 75 (Murray), as introduced on December 7, 1998, would provide the same definition of domestic partners but under a different Family Code section.

<u>Implementation Considerations</u>

This bill uses the definition of domestic partner as proposed in AB 26. If a section defining domestic partners is not added to the Family Code as Section 297 of that code, the department could not implement this bill without further amendment.

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact the department's costs.

Tax Revenue Estimate

This proposal is estimated to impact PIT revenues as shown in the following table.

Fiscal Year Cash Flow Taxable Years Beginning On and After January 1, 1999 Enactment Assumed After June 30, 1999 $ Millions			
1999-00	2000-01	2001-02	2002-03
($1)	($1)	($1)	($1)

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion:

To account for the increased exclusion amounts, it was assumed that: half of all domestic partners had been in a prior relationship, half of those relationships resulted in a child, and half of those children are living with a parent who is also a domestic partner. This resulted in the addition of about 1,250 children in those relationships where the partners' employers contribute to health insurance policies which cover the child. The following discusses the methodology and data used in the analysis of the proposal.

The revenue impact of this proposal will depend on the amount currently spent by employers to provide health benefits to domestic partners and the average marginal tax rate applicable to that amount. Note that if this proposal were to become law, it is possible that the number of employers who offer health insurance benefits to their employees' domestic partners would increase significantly.

The amount spent by employers to provide health benefits to domestic partners is not known. The number of domestic partner policies is estimated as described below. About 480,000 California households are headed by a non-senior citizen unmarried couple, or just under 1 million adults (this is the 1990 Census numbers increased by overall population growth to 1997). If 95% of these households have at least one employed person and 75% of them have two working people, these households account for about 800,000 jobs.

Of the 800,000 employed individuals, about 25%, or 200,000, do not have insurance through their employment (the statewide average of workers with employer provided health insurance is 75% according to the UCLA Center for Health Policy Research). However, given a 75% probability that their working partner does have insurance, about 150,000 working partners without insurance have a partner who has employer-provided insurance.

According to background information provided by Senator Hayden for a April 22, 1997, hearing, 7% of these households are same-sex and 93% are opposite sex. From this it could be assumed that about 10,000 same-sex households and 140,000 opposite sex households have working partners who have employer-provided insurance. According to the background information, when a company offers benefits to domestic partners approximately only 1% of the employees sign up for the same-sex partners benefits and 3% of the employees for the heterosexual unmarried partners benefits.

Applying the 1% for same sex and 3% for opposite sex statistics in the background information noted above to the preceding yields an estimated 4,000 working partners who are insured through their partners' work related insurance policies. In addition to working partners of working partners, about 200,000 non-employed partners have a working partner. Of those working partners, about 150,000 of them would be expected to be insured through an employment-related policy. Applying the 1% and 3% coverage rates noted above, there would be an additional 5,000 (non-employed) partners insured through their partners' work related insurance policies. This yields a total of about 9,000 households directly affected by current law (4,000 with two workers and 5,000 with one working partner). For this estimate, it is assumed that this number may be rounded to 10,000.

The issue now becomes one of how much income is attributable to those policies. If it is assumed that employers would pay an average of $1,500 per year for a domestic partner's health policy, employer contributions would amount to $15 million annually. If the employee is paying tax on that amount at an average marginal tax rate of 6.5%, the tax on $15 million would amount to $1 million.

BOARD POSITION

Pending.